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POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

MAIL PROCESSING NETWORK RATIONALIZATION SERVICE CHANGES, 2012

Docket No. N2012-1

REBUTTAL TESTIMONY OF

MARC SCHILLER

ON BEHALF OF

AMERICAN POSTAL WORKERS UNION, AFL-CIO

APWU-RT-2

Final June 13, 2012

Autobiographical Sketch

My name is Marc Schiller. I am the CEO of Shorter Cycles, LLC, a small consultancy focused on business development and marketing. For seven years prior to co-founding Shorter Cycles, I was an independent consultant for transportation and general business clients performing market and business analysis and planning. Before that, I was a senior manager in various roles for 23 years with United Parcel Service (UPS).

My responsibilities at UPS included service as a Vice President of domestic and international marketing and strategy, and as director of marketing services, including forecasting and revenue management. My responsibilities included market and competitive analysis of a wide range of markets, private carriers and postal services in the U.S., Europe and globally, including analysis of the USPS as a UPS competitor. Further, I participated in the design and implementation of many parcel products and services across a variety of markets and market segments for many years. Examples include: Next Day Air/Second Day Air expansions; UPS Worldwide Express and Expedited introductions and expansions; UPS residential ground product rates, pricing and revenue management; and numerous other features of service introductions.

More recently, I have provided consulting services to postal operators in the European market regarding design and implementation of parcel products in the pan-European marketplace. I also have provided strategic market and analytical consulting advice to a variety of clients and interested parties on postal matters in the U.S. and in Europe.

I graduated with a bachelor's degree in economics, with distinction, from the University of Michigan, and I received an MBA, with a focus on marketing and finance, from the Harvard Business School.

I have not previously testified before the Postal Regulatory Commission.

Shorter Cycles

Shorter Cycles was founded for the purpose of providing "targeted business development" to assist clients in positioning products and concepts effectively in target markets with target customers and to assist in taking those products and concepts to market efficiently and effectively. We also provide more traditional consulting in market analysis and product development.

The Shorter Cycles team for this assignment includes two very seasoned consultants with experience in marketing and product management in the small parcel market. Jim Lynch is a fifteen year veteran in retail and brand marketing with UPS. Before working at UPS, Jim was in marketing with The Coca Cola Company. He has significant experience in market research and customer analysis; he led the research component of this project. Jim has been active as a consultant for five years. Jim holds a BA in Business Administration from Seattle University and an MBA in marketing from Emory University Goizueta School of Business.

Sheppard Vars has over eighteen years of small parcel marketing experience with UPS, with responsibilities for the residential market segment, retail markets, and a variety of other product management responsibilities in the U.S. and globally. His focus for the project was to analyze the impact of the proposed changes on parcels and to assess the opportunities in the parcel market. Sheppard has been consulting for two years, with an emphasis on the mail and parcel markets. Sheppard holds a Bachelor of Science degree in Business Administration from the University of North Carolina. He also received a Masters of Business Administration degree from the J.L. Kellogg Graduate School of Management at Northwestern University, with concentrations in marketing, transportation and finance.

I. PURPOSE AND SCOPE OF TESTIMONY

The Postal Service has identified cost reduction as one component in its plan to reduce its financial deficits. The network rationalization plan proposed by the USPS is intended to reduce costs by closing or consolidating mail processing facilities; but that proposal involves changing operating plans and closing so many facilities that service standards would have to be materially degraded.

The purpose of this testimony is to explain the likely adverse consequences in the market associated with the purposeful degradation of service standards. This examination includes qualitative market research into customer reaction to the changes, customer perception of the impact from the changes, and assessment of the likely impact of the proposed changes on the parcel products. This testimony will also examine opportunities in parcel markets to find strategic alternatives to grow the business.

The Postal Service network rationalization proposal is the result of short-term thinking with a heavy focus on cost reduction. Furthermore, the overwhelming focus on reducing cost has not been balanced with an appropriate evaluation of strategic opportunities to develop new revenue streams. In order to maximize cost savings, the Postal Service proposes to reduce costs by relaxing the service standards of First Class Mail (with the very strong possibility of affecting other postal products). However, the relaxing of service standards seems short-sighted and there is no evidence in this case that the Postal Service has considered the long-term consequences of dramatically reducing its mail processing network.   Relaxing service standards may cause a significantly increased runoff of existing volume and revenue and it may preclude excellent opportunities to grow in the very attractive Business to Consumer parcel market.

II. EXECUTIVE SUMMARY

The network rationalization plan proposed by the USPS, with the concurrent plan to degrade the service standards of mail, essentially represents a dis-investment in the network of the Postal Service for the purpose of finding cost savings. Cost savings are important, but dis-investment and degradation of service may create significant risks that outweigh the value of the cost savings.

We have identified three important risks facing the Postal Service as a result of its network rationalization plan:

- First, there is the risk of much more volume loss in First Class Mail (FCM), and, further volume loss in other classes of mail, particularly in parcels.
- Second, there is additional risk posed by the collective changes in service perceived by customers and further compounded by the growing awareness among customers of the entire context of the difficulties facing the USPS.
- And, third, there is a very real risk of opportunity costs from dismantling a network with significant inherent value for the future of parcels.

Under the USPS plan FCM will be degraded significantly by the closings of multiple facilities. The USPS proposes to move all FCM to 2-3 day service standards, including FCM parcels of about 1 million per day.[1] Customers know that few

[1] We recognize that there have been recent changes to the make-up of the market dominant parcels products and that a significant volume of FCM parcels have been transferred to the competitive products list. Order No. 710, Docket No. MC2011-22 (April 6, 2011) approving removal of commercial First Class parcels from the market dominant product list and adding "Lightweight Commercial Products"** to the competitive products list; see also Docket No. MC2010-36, Order 689, (March 2, 2011) (Commission approved the transfer of Standard Mail Parcels to competitive products list). Notwithstanding this transfer, the risks and concerns regarding parcels described in this testimony remain. ** Though tentatively called "Lightweight

alternatives exist for FCM so they have little choice but to accept the change. Nonetheless, the added day of service for all of FCM is troubling to customers and most say that they will actively consider alternative means of delivery for parcels.

Customers of the USPS are simultaneously tolerant and adaptable but deeply skeptical and concerned. When customers consider the context of the entire set of conditions facing the USPS, many are extremely pessimistic about the survival of the institution. Such customers say that they may divert much more volume away from the USPS to protect their own interests.

The network of the USPS that processes and transports mail and parcels is a vital link between shippers and consumers. To dismantle the network and reduce service commitments on mail and parcel products is a retreat from the current standards and direction of the small parcel industry.

So the first two risks are very clear to customers: Due to the service downgrades themselves and then the collective impact of additional service changes in the context of the Postal Service's generally poor financial condition, there is a very strong likelihood that volume diverted by customers will be much greater than the Postal Service has estimated.

The third major risk to the USPS caused by network rationalization is the opportunity cost that comes with dismantling a network that could be the basis and foundation for new expansion into the growing parcel market. By closing key facilities and moving service standards back from present levels, the Postal Service risks

Commercial Products," the Postal Service has most recently referred to this new competitive product as "First Class Package Services." This testimony uses the most recent labeling.

positioning itself as mainly a fringe player in the market for parcels. That the Postal Service would move in the wrong direction in its best prospective market is, in our opinion, plainly a mistake.

An additional concern relates to the parcel strategy of the Postal Service. What is that strategy? IS there a parcel strategy? These are relevant questions to the future of the USPS as they represent a clear choice to shift resources and attention to new potential revenue streams such as the opportunity in parcels.

Opportunity

We believe the opportunity in the Business to Consumer ("B2C") parcel market is very large and fast growing due to the trends in e-commerce. The USPS has a 20% share of volume in B2C but much lower measured in revenue. Competing in the B2C market strongly favors maintaining and investing in a fully capable network operation with strong features of competitive time-in-transit and reliability, including overnight ground service in regional markets.

Further, if the USPS were to develop full capability in the B2C market, it would effectively improve its position to participate more fully in the Business to Business ("B2B") market, where it has a limited volume share today of 6-8% and lower measured in revenue share. The B2B market is very competitive but is a large market where a third player would be welcomed by customers.

The combined new annual revenue potential for the USPS in these markets is approximately $11 billion on a ten-year horizon, from a current base of USPS parcel revenue of $8 billion, representing an annual growth rate of approximately 8-9% from $8 billion to nearly $ 20 billion revenue in parcels per year in ten years. Significant commitment to product development and implementation is required to achieve a goal of this magnitude. But the foundation exists.

The USPS needs a parcel strategy and commitment to grow the business. That strategy should include a commitment to full network capability to achieve the best possible results.

III. OVERALL PROJECT METHODOLOGY

- We examined documents included in this case as well as previously published or provided by the USPS.
- We also examined additional secondary sources to fully understand the state of the Postal Service as well as the details of the current case.
- We commissioned a modeling effort to simulate the Priority Mail impact given that little other data was available to assess the impact on competitive parcels.
- We examined the market in depth through secondary research (periodicals, reports, studies, articles, etc), obtaining market data from a respected industry source and combined all of these with our own industry knowledge to form a relevant, current picture of the parcels market.
- We supplemented this effort through In Depth Interviews ("IDIs") and discussions with subject matter experts ("SMEs")[2] to capture the voice of the customer and experts in the industry.
- We developed analysis that combines all of the above sources of information as well as our own knowledge and experience in the industry.
- We offer a perspective on the growth opportunity in the parcel market.

[2] Our Subject Matter Expert (SME) sources include current and former senior management from: USPS; UPS; FedEx; 3rd party consolidators; parcel rate and pricing analysts; industry consultants and other experts in the market.

IV. MARKET RESEARCH SUMMARY

Shorter Cycles, LLC (SC) was engaged to do a qualitative assessment of the Postal Service's strategic network rationalization plan. In order to better understand customer perceptions of the issues surrounding network rationalization plans and the entire context of USPS problems and opportunities, especially as they relate to parcel shippers, we conducted in-depth interviews with 17 parcel shippers. The shippers were a mix of small, medium, large and 3rd party consolidators. All were shippers of parcels with the USPS but most also used private carriers.

A. Key Findings

1. Risk of customer runoff is potentially much greater than the official market research submitted by the USPS in its testimony.

2. The qualitative results of our discussions are much more consistent with the results of the "abandoned" research conducted August 2011 by the USPS. Customers have great fear and concern for what may happen next year and after: Will the USPS continue to further contract its overall service? Customers see great risk going forward.

3. Customers would like to see the USPS succeed. Of course, customers want to see service continue unchanged for their own needs; but, more importantly, they would like to see the USPS compete more effectively in the parcels sector, requiring the USPS to perform better overall.

Clearly, customers are not unaware. They sense the real risks around the big issues facing the USPS. It would be foolish, in our opinion, to minimize the potential for adverse customer reaction to the changes proposed. And, more so, it would be smart to listen to customer needs for better service and more competition.

The full market research report is attached in Appendix 1. Also attached is the Interview Guide used in our customer discussions as Appendix 2.

V. THE PARCEL IMPACT

A. Risks of the Network Rationalization Plan Initiative

The USPS argues that, based on market research, the proposed changes to First Class Mail and Periodicals service standards would be accepted by mailers with relatively little objection. However, the research as presented by witness Elmore-Yalch (USPS-T-11) was quite narrow and addressed parcels in a cursory manner. Further USPS testimony indicates that little impact on USPS parcel service standards and capabilities is expected from the plan and suggests that there is little risk to losing parcel volume and revenue.

The following points of evidence suggest otherwise:

1. First Class Mail is arguably the primary driver of network assets; therefore, attempting to better utilize and potentially consolidate network facilities, the proposed initiative has focused almost entirely on First Class Mail. The market research study that forms the basis of USPS estimates of revenue loss, did not appear to adequately address the impact on Standard parcels, Package Services, Priority Mail, Express Mail or Parcel Select, as these products are also processed largely through the same network facilities. Testimony and interrogatory

responses clearly indicate that the research gave little consideration to parcel services.[3]

2. Analysis of USPS testimony and interrogatory responses further reveals that the USPS has likely performed little or no analysis regarding the effect of proposed network changes on parcel service capabilities and service standards, even suggesting that they are not capable of conducting such analysis based on currently available information.[4]

3. Despite the apparent lack of analysis, the USPS states that Standard Mail and Priority Mail service standards will not change. This statement seems to refer only to service standards at the overall service level and omits the possibly significant changes in the actual service experienced by shippers. For example, the overall service standard for Priority Mail calls for delivery in 2-3 days. Claims that service standards will not change based on this definition are misleading and ignore the more detailed definition of service standards put forth in Federal Register Notice, 76 *Federal* Register 77942, which states

> *A. Service Standards Generally*
>
> Before describing how service standards will be revised, it is important to understand how service standards are structured. Service standards are comprised of two components: (1) a delivery day range within which all mail in a given product is expected to be delivered; and (2) business rules that determine, within a product's applicable day range, the specific number of delivery days after acceptance of a mail piece by which a customer can expect that piece to be delivered, based on the 3-

[3] Tr. 3/711.

[4] See Response of USPS Witness Williams USPS/APWU T1-34(c), filed March 15, 2012.

Digit ZIP Code prefixes associated with the piece's point of entry into the mail stream and its delivery address.

Applying this definition, service standards at the 3-digit Zip to Zip level may in fact change for Standard parcels, Package Services and Priority Mail.[5]

4. Customer interviews and discussions with subject matter experts conducted by Shorter Cycles indicate that parcel shippers will be very sensitive to changes in service standards that increase transit times (days to delivery).

5. They also emphasized that any change in Critical Entry Times (CET's) requiring induction into the USPS system at an earlier time of day would be detrimental to their business in terms of operational efficiency and lost sales.

Our findings reveal a new competitive angle in the industry among online retailers: retailers are now explicitly competing on the basis of "order-to-delivery time". Today's on-line retail competitive dynamics point to the combined importance of retail fulfillment capabilities, parcel service standards and CETs. The term "cycle times" was used by respondents to describe the number of hours from induction time (per CET's) to delivery. For example, the cycle time for a shipment with a CET window ending at 5 p.m. on Monday and delivered at 11a.m. on Wednesday would be 42 hours.

Shippers and SMEs were clear in stating that cycle times will be closely monitored by large shippers, and they will have contingency plans in place to

[5] See USPS Witness Neri Response to to APWU/USPS-T4-3 (Tr. 5/1875); and USPS Witness Williams Response to APWU/USPS T1-34 (filed March 15, 2012).

divert. If the proposed network/service standard changes affect parcel transit times and/or CET's, volume runoff likely would be greater than predicted by the USPS, perhaps substantially so.

6. If service standards for parcels are negatively impacted by the network consolidation, additional friction points will arise for many shippers. Analysis of our interview results revealed the following additional areas of potential concern:

   a) Increase in time and costs associated with the transport of shipments from the customer facility to a USPS induction point due to greater distance travelled.

   b) Costs of reprogramming software used to either determine the appropriate carrier/service combination for individual shipments or inform the purchaser of expected delivery day.

   c) Increased customer phone calls and complaints, particularly during transition, driving increased costs.

B. Impact by Parcel Class

It is appropriate to examine the potential impact of the proposed network changes on competitive parcel classes as well as non-competitive parcel classes. Competitive products are important to the overall health and growth of the USPS, they contribute to the overall financial condition of the USPS. They are top-of-mind for any shipper that uses those products. It is reasonable then to believe that any changes related to the network that affect parcels are pertinent to this case.

1. Non-Competitive Parcel Classes

Although substantial First Class Mail parcel volume will receive slower service in the future, shippers of these non-flat items up to 16oz. have no meaningful price-competitive alternatives. Based on personal experience, we know that FedEx and UPS do not generally achieve positive margins at the low price levels and resulting revenue per piece of First Class Mail parcels. Particularly difficult for the private carriers are the price-points on light-weight parcels in short-distance rate zones. However, the low cost to shippers for FCM parcels may not be enough to overcome the perceived loss of value from a reduction in the overnight delivery areas of USPS parcel products, coupled with a similar significant decrease in two-day coverage. Such a move will reduce the value both shippers and consignees receive today. Shippers now using the USPS will likely find the new service standards to be inadequate for certain time sensitive items and will be compelled to use more expensive alternatives available from competitors for such shipments.

Analysis comparing FY2012 Q1 origin service standards to proposed standards as reflected on the RIBBS website indicates substantial potential degradation in service standards across all protected parcel classes. Results of this analysis are discussed below and summarized in Table 1.

Table 1

Service Standard Changes (Proposed)

3-digit Zip Code Origin/Destination Pairs

Change in Standard	First Class Mail	Periodicals	Package Services	Standard Mail
Slower	136,980	222,040	42,623	28,321
Faster	230	186,725	37,106	436,631
No Change	711,896	440,341	769,377	384,154
Slower	16.1%	26.2%	5.0%	3.3%
Faster	0.0%	22.0%	4.4%	51.4%
No Change	83.8%	51.9%	90.6%	45.2%

The data in Table 1 reflect, by class, the estimated number and respective percentage of 3-digit origin/destination pairs that would experience a change in service standards under the USPS proposal. The sources for this data are found on the RIBBS web site under the file names *Origin Entry Service Standards FY12 QTR3* and *Future Originating Service Standards (Market Dominant*).

Despite the fact that Table 1 shows improved (shorter) service standards for some O/D Zip Code pairs, the most important figures are the percentage of total O/D pairs within each class that will be assigned a slower service standard than today. All customers experiencing a slower standard for lanes on which they commonly ship are at risk for volume diversion. The more degraded lanes any given customer experiences, the more the risk for that customer to divert.

2. Competitive Parcel Classes

Competitive product classes are also considered in the context of potential service standard degradation due to network changes.

It is reasonable to expect that plant consolidations driven by this initiative will affect the competitive products since some locations to be consolidated currently process competitive products. Users of these products today experience actual service levels that reflect a combination of 3 digit Zip-to-Zip service standards and actual performance to those standards. If customers experience a reduced actual level of service in the future (slower standard, worse performance, or both), the risk to existing revenue and profit contribution from customer runoff will likely be greater than presented in the USPS testimony.

First Class Package Service

As of January 22, 2012, a substantial portion of First Class Mail parcel volume has been reclassified to the new competitive product included in the most recent product listing as First Class Package Service.[6] Despite the reclassification, service standards will be the same as for First Class Mail Parcels. Therefore, the impacts and risks of the proposed network changes on First Class Mail Parcels (page 15 of this testimony) apply to First Class Package Service as well. However, the USPS will have greater pricing flexibility under a competitive product classification. The risk of First Class Package

[6] 77 Federal Register 13197, March 6, 2012.

Service volume diversion will be even greater if the USPS chooses to raise rates more aggressively in the future.

Priority Mail

Our focus for competitive products is on Priority Mail as it is the most important of the competitive products in terms of opportunity. It is also clearly an area of concern registered by customers in our market research. Our analysis suggests that although Priority Mail is not directly referenced in the Federal Register document quoted above, the general meaning of "service standards" as described therein should apply to Priority Mail as well. Priority Mail currently offers a service standard of 2-3 days at the overall service level.

USPS witness Williams has testified that Priority Mail service standards will not change, except for possible changes due to the network reconfiguration. Yet 22% of Priority Mail volume currently flows through facilities recommended for consolidation. The possibility, even the likelihood, that some 3 digit Zip-to-Zip pairs would experience degradation in service standards is evidenced by the interrogatory response by Mr. Williams:

> **APWU/USPS-T1-34** Page 26 of your testimony states that "[t]he Postal Service will continue to provide a 1-3 day Priority Mail service after network consolidation is implemented," and that it will also "continue to provide overnight Express Mail service." Your testimony further states that for both Priority Mail and Express Mail, "[t]he standards from each origin zone to the remainder of the country will be defined by the capability of the realigned mail processing network."
> a) What will be the impact of the realigned network on the service standards of these competitive products?
>
> **RESPONSE**
> a. The service standard day ranges are not changing. However, network

> changes may result in changes in the expected delivery day within each range for specific origin-destination ZIP Code pairs. Now that almost all facility-specific consolidation determinations have been made, the Postal Service is currently evaluating new service areas and assessing any potential changes required for Express Mail and Priority Mail service standards

Due to the lack of proposed Priority Mail service standards, a modeling effort was undertaken to simulate the impact to Priority Mail. At our request, a network simulation on Priority Mail was run by Decision/Analysis Partners in conjunction with other model runs developed on behalf of our mutual client, the APWU. The description of the Priority Mail simulation model run is attached as Appendix 3. The Priority Mail model output provides the expected change in service performance between a baseline of the current network and a simulation of the consolidated network. The comparison is based upon the number of Priority parcels and flats reaching their destination 3-digit ZIP code in 1, 2, 3, or 4 days, and the percent missing their Modern Service Standard (FY12 Qtr3 published standard) under both network configurations. Any decline in performance when comparing the future scenario to the baseline is attributed to the change in network configuration. Table 2 provides model-estimated service performance statistics assuming an 8AM arrival deadline to the centroid of the destination 3-digit ZIP code.

Table 2

Priority Parcels Service Performance Assuming 8AM destination arrival deadline

	Time-in-Network By Volume…				% Missing Published Service Standard
	1-Day	**2-Days**	**3-Days**	**4-Days**	
FY10 Baseline (112 Plants)	14.8%	65.9%	19.1%	0.2%	19.7%
Post-NP (129 Plants)	14.0%	65.4%	20.4%	0.3%	20.9%
					1.2%

The results of the simulation model[7] suggest an additional 1.2% of Priority Mail would fail to meet today's service standards under the proposed network configuration. This is a proxy for longer time-in-transit relative to pre-rationalization.[8] The model is conservative in that it relies on on-road transportation time constraints without assuming any change in other operational constraints. The model supports a directional conclusion that a portion of Priority Mail will see degraded time-in-transit as a result of network rationalization. Priority Mail is the most substantial "premium" parcel service offered by the USPS in terms of volume and revenue and the most viable in terms of competing for market share. However, the product is put at risk if time-in-transit commitments are degraded in favor of a reduced network. Our customer interviews reveal deep concerns that the USPS is "moving in the wrong direction" on service changes. Any impacts to Priority Mail are likely to cause great concern and lead to further volume runoff.

The USPS has not been forthcoming with any analysis or plans to address potential impacts on Priority Mail. However, the number of facilities in which Priority Mail will be processed has changed over the course of this case from 112 prior to rationalization, to 87 and now 129. This increase suggests that additional costs will be incurred to preserve Priority Mail capabilities to some degree.

[7] Appendix 3, revised May 22, 2012.

[8] As defined in 76 Federal Register 77942, quoted on page 12 above, service standards include "business rules that determine, within a product's applicable day range, the specific number of delivery days after acceptance of a mail piece by which a customer can expect that piece to be delivered, based on the 3- Digit ZIP Code prefixes associated with the piece's point of entry into the mail stream and its delivery address."

Implementing this initiative with such a high degree of uncertainty about the service impact to a profitable and growing product in an attractive market segment is imprudent.[9]

C. Risk in the Broader Context

The broader context in which the USPS network rationalization would be implemented is cause for additional concern. Shippers are generally very aware of the current condition of the USPS and the challenges it faces as First Class Mail volume continues to decline. Many perceive that the USPS has been engaged in a long struggle to consistently achieve profitability. Most shippers are aware that operational and service changes beyond the scope of network rationalization have been proposed and that additional changes of some sort are likely in the foreseeable future.

As the USPS proposes to implement several seemingly independent changes that directly affect customers in an effort to meet and maintain financial objectives, the greater context described above becomes a necessary and crucial consideration. Customers are forming perceptions of USPS capabilities, value proposition, and even long-term viability based on all of the inputs coming at them from the news media, their own experience and even the Postal Service itself. It is therefore prudent to recognize and consider this greater reality, even when designing independent initiatives to tackle the very real challenges the USPS faces. It must be considered that customer reaction to the service standard changes resulting from network optimization as currently proposed could be much more severe than reflected in the USPS testimony. This risk is

[9] Express Mail and Parcel Select are not addressed here as they are likely not affected by the Network Rationalization plan specifically. Although these products may be affected due to distance and time constraints caused by changes in the locations of facilities into which customers induct volume.

clearly borne out by our customer interviews and, quite similarly, the USPS sponsored market research discussed below.

1. Risk Exposed in Market Research

The USPS sponsored two quantitative studies in order to support the recommended network changes. The study that supports the analysis presented in the original written testimony on behalf of the USPS was fielded in October 2011. As testified by witness Elmore-Yalch (USPS-T-11), the research described the results which indicated relatively modest negative customer reaction. Witness Whiteman (USPS-T-12) testified that the analysis based on this study projected annual revenue loss of $1.3 billion and reduced overhead contribution of $499 million attributable to volume lost due to this initiative. While volume and revenue would be shed, the net result of the analysis was a net annual savings of $2.1 billion[10] achievable through the network facility closures and service standard changes as proposed. However, an earlier phase of the market research study, conducted in August, 2011, indicated in preliminary results that strong negative customer reaction would lead to substantial runoff of volume. This study was subsequently "abandoned" and not revealed in the initial USPS testimony. In subsequent testimony, witness Elmore-Yalch testified that the abandoned research was sound except that the data collected in the earlier phase had not been scrubbed. The main difference between the two studies lies in the description of the situation and proposed initiative provided to each respondent prior to testing their reaction.[11] In our

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[10] Direct Testimony of USPS Witness Masse, USPS-T-2, at 11-12
[11] Compare Direct Testimony of USPS Witness Rebecca Elmore-Yalch (USPS-T-11) at 100, 127, 142 and USPS-LR-N2012-1/70.

opinion, the abandoned research more accurately reflects the context, relative to the USPS, within which customers will adjust their shipping behavior over time.

As reflected in APWU-XE-1,[12] the abandoned research and subsequent analysis result in forecasted annual revenue decline of nearly $5.3 billion and reduced overhead contribution just shy of $2 billion, offsetting nearly all cost savings expected from this initiative. We find this outcome to be much more consistent with the deeply concerned sentiments of customers in our own research. Indeed it suggests great risk exists.

VI. THE PARCEL OPPORTUNITY

The parcel delivery market offers a meaningful growth opportunity for the USPS. By virtue of its network, delivery footprint and its trusted standing as a service institution, the USPS is a natural player in the parcel delivery market. Parcel transportation is a critical cog in the U.S. economy. Although the USPS's mandate is primarily to maintain the universal service commitment to the delivery of First Class Mail, the Postal Service is already an important player in parcel delivery, active mostly in the B2C residential delivery segment of the market. (The B2C market is generally also known as the residential parcel delivery market and is occasionally referred to as such in this testimony).

The current USPS proposals to relax standards and reduce service could erode the USPS's position in this critical industry sector. A decision to disinvest in the operating network with consequent degradation of service standards could preclude the USPS's

[12] Tr. 4/906.

ability to grow: A significant opportunity to achieve substantial revenue growth and profit contribution would be foregone, likely permanently.

A. Market Size and Trends

The total U.S. domestic parcel delivery market (B2B and B2C combined) is large and growing, generating revenues of $60-70 billion annually, comprised of B2B at $50 billion and B2C at $15 billion, and growing at nearly 3% per year.[13] The overall market is fairly dominated by UPS and FedEx at roughly 51% and 32% share respectively, with the USPS at 11-12% and small regional players making up the remainder.

At $15 billion, the B2C parcel market is roughly 20-25% of the total parcel market. UPS and FedEx are again rather dominant with roughly 52% and 26% revenue share respectively of the B2C segment. The Postal Service has about a 20% share and the remainder is spread among regional providers and consolidators.[14] In 2011, the B2C parcel delivery market grew at approximately 3.8%. Growth is forecast to be 5.5-6.5% over the next 5 years, resulting in nearly a $20 billion B2C parcel shipping market by 2016.

The B2C sector has grown significantly in recent years and will continue to do so for the foreseeable future. Most of this recent growth has been fueled by e-commerce, specifically goods purchases made on-line by consumers. According to Forrester Research, on-line retail sales currently account for only approximately 7% of all retail sales. On-line purchases are expected to rise to 9% of all retail purchasing by 2016,

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[13] The parcel delivery market as discussed here excludes First Class Parcel and First Class Package Service which were not in effect as of 2010.
[14] Colography Group, Inc. (http://www.colography.com/) and other industry sources.

supported by an annual growth rate of 10.1%. On-line sales are accelerating and there is tremendous upside with the trend expected to continue for many years. Mobile device shopping solutions will add further momentum. All of this activity generally culminates in the need for physical transport and delivery of the purchased goods to the end consumer, resulting in similarly high growth expectations for the B2C parcel delivery industry.

B. USPS Opportunity

Given the market size, share numbers and sources of specific opportunity discussed above, analysis of the B2C parcel market indicates a significant and achievable opportunity for the USPS. We believe the opportunity could provide accelerated growth in parcel volume and revenue over the next 10 years. We would expect a growth rate of 8-9% for USPS parcels through greater penetration of the existing market and greater participation in future market growth. The official USPS strategy documents produced in 2010 forecasted a 3% CAGR for total USPS parcels through 2020.[15] We believe far more substantial growth can be achieved.

Overnight Ground Parcel Segment

As an example, consider this key segment of the ground B2C market: Short-zone ground delivery within 350 miles, mostly overnight.

- Total ground parcel volume is 5.5 million per day

[15] Boston Consulting Group, *Projecting U.S. Mail volumes through 2020 Final Report-Detail,* at page 8 (March 2, 2010) available at http://about.usps.com/future-postal-service/bcg-detailedpresentation.pdf

- 3.4 million per day in this segment (within 350 miles) 62%
- 58% of ground revenue $4.9 billion in this segment
- 32% of total B2C revenue is in this segment
- USPS has 20% share of volume and 10% share of revenue
- UPS/FDX combined share of 76% volume, 86% revenue
- UPS/FDX deliver within 250 miles (generally) overnight
- USPS Priority limited delivery overnight
- USPS Parcel Post is not delivered overnight
- USPS pricing generally competes only for under 10lb parcels
- USPS share is mostly NOT comprised of Priority Mail

With improvement to overnight capability, improved reliability and a pricing plan to compete for heavier weight parcels, the USPS could rapidly gain share in a segment for which it is essentially not competitive today.

On a 10-year horizon, with market growth of 6% in B2C ground, this identified segment alone will grow to $9 billion revenue. As a third fully competitive player in the market with significant delivery cost advantages, the USPS has an opportunity to grow from well under $.6 billion revenue per year to $3 billion per year in this segment, a growth rate of over 15% per year compounded.

Taking this example and applying it across multiple segments, one could project that the USPS could capture a 30% share of the B2C market in 10 years: grow from $3 billion annual revenue to $10 billion, an annual growth of over 12%.

Practically, of course, many key improvements must be implemented to achieve such growth, and it is prudent to project a lower growth rate, but the market opportunity exists to do so. As such, we believe a projection of 8-9% growth over ten years will result in an annual revenue stream of $8-9 billion in B2C.

Further, we believe success in the B2C parcel market opens the door to also compete more fully in the even larger B2B market for parcels. Capabilities developed in the B2C market would translate over to the B2B market. Hence, the USPS could become, over the next 10 years, a fully capable third competitor in the total domestic parcel market. In B2B market, a more modest market share goal should be expected over a 10 year horizon; nonetheless, a modest goal of 8% share-point gain (on top of the existing 7-8% share), achieved in 10 years would provide an additional $5-7 billion revenue opportunity, to $11 billion B2B revenue, an 8% annual growth rate.

The USPS could achieve a substantial position in the overall parcel market with a total parcel revenue stream of nearly $20 billion on a 10-year horizon Our research and analysis strongly suggests such a position is possible as a third competitor that would be welcomed and rewarded by the market.

C. On-line Retailer Trends and Implications

The explosion in on-line commerce has made B2C parcel delivery increasingly important to consumers and retailers alike. Shipping solutions have become a competitive tool. The cost of delivery has been increasingly utilized as a marketing tool to close the sale with on-line shoppers. Thus “free shipping” offers proliferate across retail web sites. In fact, 52% of on-line transactions in Q4 2011 included free shipping.[16] While free shipping entices purchases, this concession impacts the seller's bottom line and can pressure retailers to raise product prices. Online and traditional catalog marketers seek competitive advantages that add more sustainable value to their customer relationships.

The resulting new online retail battleground is "order-to-delivery time". With broad product choice, easy to obtain price comparisons and free shipping offers, the retailer that is consistently quickest to put the product in the customer's hands accrues a meaningful advantage. High-end on-line brands are considering offering guarantees based on order-to-delivery time with the expectation that measurable sales growth can be linked to such a guarantee. A very large, multi-channel retailer noted in an interview that they measure, in hours rather than days, their ability get products in the customer's hands faster than Amazon can.

The implications are four-fold.

1. Fast, consistently reliable, day-definite delivery solutions with latest possible injection windows are becoming more important than ever.
2. Regional distribution has become more attractive, allowing for faster order-to-delivery time with manageable shipping costs.
3. Maximum overnight ground-based delivery reach is sought.
4. Achieving the above at reasonable cost is valued necessity.

[16] *State of the U.S. Online Retail Economy in Q4 (2011)*, comScore, Inc. (February 2012); see comScore, Inc., Press Release at http://www.comscore.com/Press_Events/Press_Releases/2012/2/comScore_Reports_Q4_2011_U.S._Retail_E-Commerce_Spending

Retailers striving to differentiate on order-to-delivery performance will demand all four. And, small parcel carriers will need to meet the service requirements to participate fully in the market.

D. How USPS Is Positioned Today

The USPS participates in a relatively narrow portion of the overall parcels market. With the exception of very light weight parcels (up to 16 oz), the lack of a full portfolio, robust features, and reliable day-definite service capability virtually eliminates the USPS from consideration for most B2B shipments. Although the B2C segment is perhaps less demanding, these same constraints limit the USPS to a narrow role in the B2C parcel market as well.

The combination of products, their specific features and pricing strategies confine the Postal Service to competing primarily for light weight, low-value B2C shipments. First Class Mail and Priority Mail are the only meaningful end-to-end products. Express Mail is applicable to more urgent B2B shipments. Parcel Post is an “economy” service with minimal features and limited appeal in the on-line retail environment that drives B2C market growth. An overview of the USPS portfolio of parcels services is reflected in Table 3 below.

<u>Table 3</u>

<u>PRODUCT POSITIONING</u>

Parcel Product	Weight	Service Standard	Positioning
First Class Mail/FC Package Service	**< 16 oz.**	**1-3 days[17]**	• **Economical** • **No price competitive alternatives** • **Captive market with exception of high value items**
Parcel Post	**≤ 70 lbs.**	**2-8 days**	• **2-8 day delivery** • **No 1-day delivery coverage** • **Very limited features, no tracking, extra charge for delivery confirmation** • **Price competitive vs. UPS/FDX Ground up to 10lbs. but not comparable in features, commitment, reliability, etc.**
Express Mail	**≤ 70 lbs.**	**1-2 days**	• **Competitive price and features** • **Saturday delivery advantage**
Priority Mail	**≤ 70 lbs.**	**2-3 days**	**Lacks clarity in position vs. competitors** • **Positioned vs UPS/FDX Ground in zones 2-4** - **Price competitive up to 10 lbs., BUT…** - **Very limited overnight coverage (1.1% of 3 digit O/D Zip pairs)** • **Positioned vs UPS/FDX 3-Day and 2-Day Air products in zones 5-8** - **Price competitive up to ~ 8-13 lbs. depending on zone, but well above UPS/FDX Ground** • **Partial Saturday delivery advantage (FedEx Home Delivery offers Saturday delivery)** • **No tracking, extra charge for delivery confirmation** • **No guarantee**
Parcel Select **&** **Parcel Select Light**	**≤ 70 lbs.** **< 16 oz.**	**2-9 days**	• **Positioned as "last-mile" service** • **Flexible drop ship solution, multiple entry points** • **Incents shippers to bypass USPS network using <u>competitor services</u>** • **Formerly classified as Standard parcels** • **Regional Rate Ground special short zone pricing**

[17] The service standard is expected to change from 1-3 days to 2-3 days after implementation of the current Postal Service proposal.

FedEx, UPS and a number of regional parcel carriers all offer capabilities that meet the requirements of the B2C as well as B2B shipping customers. They do so by presenting a cohesive, well-defined portfolio of products and services that are aligned with customer needs and clearly communicated. These services are designed with the customer in mind, seeking to address ever-changing market demands.

The USPS product portfolio is poorly positioned in this regard. The array of USPS products, defined and often named based on USPS operational capabilities and requirements, is neither customer friendly nor inclusive of the features parcel shippers demand. This condition leads to limited opportunity and the unfortunate position of competing solely on the basis of price. Shippers clearly articulated frustration with these issues during our shipper interviews.

First Class Mail and First Class Package Service fill a clearly defined parcel niche – parcels under 16 ounces - with virtually no competitive pressure. With few exceptions, the volume in this segment accrues to the USPS by default. While Parcel Select may appear to offer a competitive alternative, it is effectively a means for the USPS to outsource sort and transport activities. By adjusting Parcel Select pricing levels, the USPS can greatly influence the volume levels of Parcel Direct relative to First Class Package Service. Among products weighing less than 16 ounces, only high value and tightly regulated/controlled shipments are likely to be delivered by competitors. The primary exception arises when shippers with very few lightweight packages find it easier to allow a single carrier, usually FedEx or UPS, to move all of their parcels. In that case, the lightweight parcels are simply tagalongs that do not drive shipping decisions.

Priority Mail, then, is the single end-to-end USPS product in the competitive service classes with a meaningful role in the parcels market. The product is positioned somewhat against the ground and deferred-air services of FedEx and UPS. In terms of transit time and price, Priority Mail attempts to straddle the space between, ultimately matching up poorly against both. More critically, Priority Mail lacks critical attributes highlighted in the earlier discussion of online retail trends. Chief among these attributes are day-definite service commitments and overnight delivery coverage. Full tracking and high reliability are "minimum bid" features – essentially the price of entry to compete in the broader B2C market. Additionally, pricing and operational constraints limit Priority Mail to lightweight, lower revenue per piece parcels.

Parcel Select has a clear positioning as a drop-ship offering, but its success with this service comes at a price. The nature of the service separates the USPS from the shipping customer, ceding this relationship to competitors such as UPS, FedEx and a host of consolidators. Rather than further leveraging its significant network capability, the Postal Service is incenting customers to bypass much of the USPS network, arguably forfeiting profit opportunity to the competition.

E. Specific Areas of Opportunity

1. <u>Overnight Service Capability</u>

Shipments up to 350 miles account for over 50% of the B2C market, equating to $8 billion in revenue. The network reductions sought by the USPS would limit its ability to offer this most basic service feature presently available in the marketplace. The

USPS network consolidation would result in elimination of overnight capability for First Class Mail, leaving a network incapable of addressing an increasingly important portion of the market.

2. National Ground

The USPS portfolio also lacks a viable "national" ground service. FedEx and UPS both offer robust 1-5 day products that provide an economical alternative to Express services. These ground services carry premium features of guaranteed day-definite delivery, end-to-end tracking and very high reliability (>98% on-time delivery). B2C Ground revenues for FedEx and UPS total approximately $7.6 billion, with no other competitive alternatives available in the market.

3. Heavier Weight

On average, the USPS captures significantly lower weight parcels than either FedEx or UPS. Higher weight drives greater revenue per piece, ultimately resulting in higher margins. Per piece weight and revenue for each carrier are displayed in Table 4.[18] The USPS is currently constrained in both pricing and operations capability relative to higher weight parcels, and could benefit greatly by attracting heavier shipments and improving the overall weight profile of volume transported.

Table 4

2010 Weight and Revenue per Piece

	FedEx	**UPS**	**USPS**
Weight /pc	6.9 lbs.	7.2 lbs	3.0 lbs
Revenue/pc	$10.16	$8.28	$4.58

[18] Data reflect 2010 estimates by Colography Group

F. Competitive Trends in Parcel Delivery

As the USPS gradually sheds capability, the market is growing and becoming more attractive. Therefore others are innovating and investing to seize the B2C opportunity, capturing value that could belong to the USPS.

- Shippers today place increasing importance on cost-effectively providing the fastest possible order-to-delivery service to their customers. FedEx and UPS continue to push the limits of their one-day ground coverage, but their sheer size and the integrated nature of their operations create some constraints. As a result, more nimble service providers are able to design operations around key markets within a given region, offering similar service features with maximized ground coverage. They can simply go further, faster, and at lower cost. Growing firms such as OnTrac, Lonestar Overnight and Eastern Connection have carved out a profitable niche by offering competitive, full featured overnight delivery in their respective regions. Sample service maps comparing overnight delivery capability of OnTrac and UPS from Los Angeles and San Francisco origins are provided in Appendix 5 for reference.
- FedEx SmartPost and UPS SurePost leverage USPS last mile capabilities as they battle to win B2C shippers. These are now full-fledged service offerings capable of transporting a wide spectrum of items from mail all the way up to parcels of 70lbs. By encouraging drop shipping through Parcel Select, the USPS has led shippers to bypass much of the USPS network, effectively reducing the value of a valuable institutional asset that is already in place. In most cases, shippers

themselves do not wish to run in-house transportation networks, so they rely on others to provide the needed service. The result is that FedxEx and UPS have been able to expand the market in which they compete by developing specific products to provide consolidation and line-haul to USPS drop points. In so doing they bypass the bulk of the USPS network, capturing value that would otherwise accrue to the USPS and displacing USPS customer relationships.

- Consolidators and reverse logistics players are “partnering” with the USPS through Parcel Select as well. These firms tend to focus exclusively on this sector of the market attracted to drop-shipping as opposed to offering a broad array of full-service ground and express capabilities. These mail and parcel consolidators are in business specifically to take advantage of the USPS Parcel Select offering, again reaping profits that could belong to the USPS. Examples of parcel consolidators include Blue Package Delivery, DHL Global Mail, Fairrington Transportation, Kaleidoscope Services, Newgistics, OSM Worldwide, ParcelPool and SP Express.[19] Many of these have invested in their own hub and feed networks in order to take advantage of the opportunity afforded by the USPS Parcel Select program.

Regional, ground-based parcel delivery companies, the large integrators (FedEx and UPS), and specialized mail and parcel consolidators have built products and complete businesses around the opportunities afforded by changing market demands. At the same time, the USPS is moving away from overnight delivery and end-to-end mail

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[19] Rob Martinez, “Low Cost Parcel Options for Residential Shippers,” PARCEL, (May/June, 2011).

and parcel service capability despite already possessing a valuable operating network that could be adapted to better capture these opportunities and associated revenues.

VIII. CONCLUSIONS

We believe the USPS is at a critical juncture. The operations have great inherent value that is presently subjected to the stress of losing FCM revenue. The reaction of the USPS to cut costs is understandable; but to do so through the relaxation and degradation of service standards runs counter to the major trends of the industry and expectations of customers.

Customers have been put into a difficult situation: they are willing to adapt their processes and methods to the needs of the USPS in order to support its survival. However, when discussing the full context of the situation and the range of USPS plans to reduce service, customers have deep concerns about the viability of the USPS. Customers would like to see success, but they are very skeptical. Customers would likely divert serious volume in order to protect their own business interests.

We believe the network rationalization plan proposed by the USPS would create great risk in the market for the USPS, both in the possibility of much greater volume diversion but also in the perception of heading deeper into a “dead end” which could preclude participating in market opportunities.

Three significant sources of risk exist:

1. Volume loss specifically due to the proposed service changes.
2. Greater volume loss due to deep customer concerns for the future.
3. Opportunity cost from dismantling the network.

The proposed network rationalization is a move in the wrong direction. The changes would be substantial and largely irreversible once implemented. Based on the collective parcel industry experience of the Shorter Cycles team, including market development, product development, product management and corporate strategy, it is clear that the risks of network consolidation as proposed are greater than presented in the USPS case. Can a final decision be properly made in the face of so much risk and uncertainty?

Subject matter experts in the industry believe the USPS has the wherewithal to make the change to parcels. They believe if the network is not dismantled, the foundation already exists from which to build. But this would require a commitment and strategic decision by the Postal Service to shift focus to parcels. SME's believe the window of opportunity is narrowing. The strategic choice and investment need to be made soon. The USPS needs to take a positive approach with a strategy to grow the parcel component of the business. But SME's also say no such strategy is now apparent.

The B2C parcel market is growing at a fast pace, spurred by the shift in consumer purchasing behavior toward e-commerce and online buying. The shift is creating significant growth in B2C parcel delivery, with the USPS participating now only to a small degree. A great opportunity exists to expand further into that market requiring investment in the network and improving products to meet various already-established competitive features. The USPS has a great opportunity to build on its delivery advantages but it will require full network capabilities[20] to provide competitive products with time-in-transit features demanded by shippers and consumers.

[20] See Discussion of the strategic choice for full network capabilities: Appendix 4

Interestingly, such an opportunity is readily achievable because the USPS is essentially in the B2C business already. The USPS needs mainly to better position its products for success and build its network to match primarily the overnight transit-time needs already clearly established in the market. Doing so will open up significant volume opportunities that exist in the market today and will position the USPS to capture new growth in e-commerce in the future.

Further, developing the full capabilities to perform in the B2C parcel market will open up an opportunity to enter the B2B parcel market in the future, yet again a far larger market. If the USPS can develop itself to be positioned as the “third major player” in the parcel market, with an initial focus on B2C, the possibility of playing effectively in the B2B market becomes very real. Many customers and industry experts expressed very strong interest for a “third major player” with a great need in the market for greater competitiveness also in B2B parcels.

Appendix 1.

Market Research Perspective

<u>BACKGROUND</u>

Shorter Cycles, LLC (SC) was engaged to do a qualitative assessment of the Postal Service's strategic Network Rationalization plan. SC undertook in-depth qualitative interviews with mailing and shipping managers across a range of postal customers to better understand the issues behind Network Rationalization and the overall outlook for the USPS.

<u>METHODOLOGY</u>

Following rigorous screening of over 40 prospects in February 2012, SC conducted 17 in-depth, qualitative interviews with managers in firms engaged, directly or indirectly, in the shipping of parcels and mail, primarily to residential (consumer) recipients. The respondents were, in some cases, large-volume users of USPS parcel products with little volume through other carriers. The majority of the respondents, however, were users of both competitive parcel delivery resources (UPS, FedEx, regionals and consolidators) and the USPS. The interviews were conducted at length in person or over the phone. Several interviews were conducted in person at the National Postal Forum in Orlando in April 2012. Questions were both rating-scale based to determine the relative value of various features and open-ended to draw as much perspective from participants as possible in the time allowed. It proved to be a very effective approach.

The interview guide began with collection of company demographics to help us maintain a wide range of qualifications among respondents. Each respondent was identified and confirmed to be an active shipper of parcels through the USPS, or competitive carriers, or both. We then discussed the specific change in service standards as proposed in Network Rationalization as well as each of the three major changes proposed by the

USPS in their broader restructuring plans. These were: 1. Changes to FCM service standards by one day; 2. change from 6 to 5 days of delivery service; and 3. retail restructuring with closings of some local post offices. We asked for their awareness of each of the proposals and sought their reactions to each and to all of them combined. Additionally, toward the end interview, we engaged the respondents in discussion of the overall context of the financial health of the USPS and its prospects in the future.

Based on estimated shipping volume and estimated company annual revenue, the 17 respondents were segmented into four groups: Small, Medium, Large, and Third Party. All are currently active parcels shippers.

Small – Independent, small business enterprises serving local, regional and national customers. Annual revenues generally less than \$5 million. Some were heavily into e-commerce, others were not.

Medium – Moderate-sized (\$25 million to \$250 million in revenues) businesses selling goods/services more on a national level. E-commerce sales sometimes small, often large, but all say growing.

Large – Annual revenues in excess of \$1 billion, these firms serve a broad customer base and generally have well-developed e-commerce businesses. Two of the firms are large-volume shippers of catalogues and direct mail as well as parcels.

Third-Party – Industry participants of three types, each with a unique perspective. These included a 1. parcel consolidator/return solutions provider, 2. a spend management firm engaged in contract analysis and negotiation on behalf of shippers (senders of parcels), and 3. a retail packing/shipping/office services franchisor. Due to the fact that these respondents either ship on behalf of multiple clients with varying needs or don't actively ship themselves (spend management provider), these interviews were in some cases free form discussions that addressed the issues in our discussion guide but did not directly follow the guide per se. In all cases, the respondents had deep industry understanding as a result of serving a wide range of shipping clients in the specific context of their parcel shipping activity.

The research methodology employed by SC focused first on the USPS Mail Processing Network Rationalization proposal, specifically on the proposed changes to the FCM time-in-transit changes, adding one day to the service standards for delivery. Next, we discussed the proposed change of eliminating Saturday delivery. Third, we discussed the proposed closing of retail post offices. To broaden the context, we discussed the general financial condition of the USPS and the significant financial challenges facing the USPS. In most cases, as the interview discussion progressed, customers were able to grasp the overall context of the present condition of the postal service relative to the specific changes in service standards that are presently under review. In this way, the interviews were able to elicit responses that dealt with the global impact of all changes rather than simply each change individually. We believe that the context of this global approach is more "real world."

The research was conducted during March and April, 2012. Each interview lasted approximately one hour. Participants were offered a $100 honorarium for their time and participation. Most chose to give the honorarium to a favorite charity.

RESEARCH FINDINGS

General

Among the variety of firms interviewed, we found fairly consistent responses from all the respondents. Overall, they respect the USPS as a reasonably-priced, generally-reliable provider of mail and parcel delivery services. The mail is considered by many people as a "lifeline", providing a reasonably priced, reliable communications channel to their customers. For parcels, many shippers are highly selective in their use of USPS services only where low-price creates good value, typically in the light-weight, low-value parcel segment. On the negative side, the Postal Service is seen as relatively customer-unfriendly, offering products that fit the postal operations rather than tailoring products to meet customer needs. It is known, for example, for its unique lexicon and terminology, with seemingly no desire or interest to adopt a more user-friendly vocabulary for its products and services.

All of the respondents want the USPS to succeed, but, interestingly, not one believes that will happen without significant change. The respondents did not hold back their opinions:

- "The Postal Service is inwardly-focused and has succeeded only by virtue of the monopolistic control of letter pick-up and delivery"
- "They have existed for over two hundred years in spite of themselves."
- "They must find a way to fix the broken machine"
- The organization will require "new blood" that recognizes how to operate a business
- "Someone will have to shake up the culture"
- "They have some people in DC HQ who seem to be pretty bright. However, when they send out a plan, it goes nowhere because the people locally don't know how to execute. Then the new concept or program dies."

RESEARCH SUMMARY

We conclude that customers, when they think about the depth and breadth of the severe financial challenges faced by the USPS, express substantial concerns about the future viability of the organization. That is when they consider shifting their mail to digital substitutes and parcel volume to competitors. For this reason, we disagree with the conclusions reached in the market research testimony of the USPS. Mr. Whiteman minimizes the volume and revenue losses due to the service changes proposed:

> "The proposed changes in the First-Class Mail service standards are not expected to constitute a tipping point for major new changes in volume decreases. Thus, we can expect First-Class Mail to continue declining with service standard changes constituting just one of several contributing factors."

For customers, it seems that these “several contributing factors” are in fact the real issues. There are many factors contributing to the potential decline of the volume of the USPS and these should be specifically and collectively considered in light of the proposed network rationalization.

Shippers honestly want to see the USPS survive and prosper, but they don’t believe that it will happen. They see the USPS at a “dead end” or in a “death spiral.” For mail, USPS has developed into a “necessity” with no real viable alternatives. Mailers will adapt and change as needed, if they are forced to do so in product offerings for which there is no competitive alternative. But the internet increasingly provides a real substitute for more and more mail. And, the big changes proposed by the USPS are frightening, even to loyal mailers, and also to parcel shippers. Most “serious” parcel shippers who want speed and reliability favor UPS, FedEx and others because the USPS is not viewed as a viable parcel competitor except in certain segments. But customers *want* the USPS to do more and to succeed; they just don’t see how it will happen. It is a very real conundrum that carries great risks for the Postal Service.

Network Rationalization

The respondents in the SC study, primarily focused on parcel delivery, are generally “satisfied” with the Postal Service for First Class Mail because it is the only letter delivery vehicle available and it is low-priced. For parcels, low price in the low-weight segments with reasonable delivery reliability provides satisfactory results. And very low levels of product features allows customers to ship parcels cheaply with few expectations. With such low expectations, it’s not surprising that customers are satisfied with the service. “This year (2011), ASCI (American Customer Satisfaction Index) expands its treatment of express delivery services to include both consumer senders and receivers. The measure now encompasses packages people pay to have sent to other people and express-delivered merchandise they pay to have shipped from companies. Customer satisfaction for the category inches up for a second straight year, gaining 1.2% to an ASCI score of 84. Double digit growth in online sales during the first quarter has increased demand for consumer-paid shipping of Internet purchases. The United States Post Office gains 3% for its express delivery services, but its score of 79 keeps the USPS well behind both UPS (85) and FedEx (83). Customer satisfaction with the Postal Service's regular mail delivery also improves over last year, up 4% to match its former high point of 74. But this gain comes at a time when the volume of mail is shrinking and the Postal Service faces financial difficulties. Indeed, higher satisfaction with the Postal Service might reflect a dwindling customer base, the most loyal of whom is also its most satisfied. The more dissatisfied customers may already have left." (ASCI Commentary, June 21, 2011)

But, as expectations change, or as more features are demanded, shippers said that they have choices (as noted in the ASCI ratings) to which they turn when the USPS cannot meet their needs.

On the specific issue of changes to the service standards of First Class Mail, most users of FCM for shipping parcels said they were willing to adapt their processes to meet the changes. These mailers use USPS for shipping products for which speed of delivery may be less important than cost. They understand what the USPS may try to do and, for mail, there is no real alternative. So they will change with the service change for mail. In the narrow context of the network changes alone, most mailers will choose not to change their behavior much. Mailers are concerned about price increases; they prefer to keep prices low. Hence, in a narrow context, the conclusion drawn by the USPS (Whiteman USPS-T-12 at 4) that network rationalization "would have limited impact on their mailing behavior and their use of the internet to mail" is seemingly correct. But, in fact, customers are not happy with the change.

However, when broadening the subject to include the shipping of other classes of mail, particularly parcel classes of mail the concerns of mailers/shippers change considerably. In standard mail, some mailers are very concerned about delivery days because of an acute need to have advertising mail arrive on just the right day. For parcels, they are quite concerned for speed of delivery and reliability. Shippers are reasonably satisfied today with the USPS for parcels in the light-weight, low-value segments, and generally consider these to be a “good value”. But their expectations are quite low for USPS parcel services relative to the private carriers. Shippers said they have choices with UPS, FedEx, regional carriers and 3rd party consolidators. As USPS’ Whiteman noted from their 2011 research, “Some customers indicated that while the proposed service changes for First Class Mail would not present a major problem to which they could not adapt, they might well accelerate their shift of communication to the Internet. Some acknowledged the availability of FedEx and UPS for important documents. They also indicated they would reduce volume by eliminating discretionary volume.” (USPS-T-12 at 7)

Generally, shippers are more inclined to accept changes in mail categories with no competition than in the competitive products. If customers do not expect or actually see any changes in transit times for parcels, then the proposed changes to FCM may have less impact. But, when shippers perceive that changes to service standards could spillover into parcel products, they are very concerned and become very wary of the effect of the bigger picture on the USPS. Parcels would be diverted to UPS and FedEx or other parcel service providers.

When asked about performance on service features, respondents overwhelmingly cited RELIABILITY as the most important feature. The respondents’ companies varied by industry and size as to the rankings of the next series of features, but the grouping was quite consistent: COST, TIME-IN-TRANSIT, DELIVERY CONFIRMATION/TRACKING were the next most important features. Of lesser importance to these shippers were DELIVERY GUARANTEE, PROACTIVE NOTIFICATION, and ELECTRONIC BILLING DATA.

Other Proposed Service Changes

Changing service from 6 to 5 days for some shippers would have minimal effect on shipping behavior. A major exception however is with catalogue and e-commerce companies, the fastest growing market segment. The e-commerce standard of immediate, free shipments, according to these shippers, must have the option of affordable Saturday delivery if they are to maximize their competitive appeal. They also foresee issues developing in the customer service area due to customers contacting the shipper, rather than USPS, when faced with lack of Saturday delivery. But, many said there would be no significant impact on USPS as a service provider for their light-weight, low-value parcel needs. Otherwise, they generally use private carriers for the bulk of their shipping.

Of the three separate proposed changes, the retail consolidation would have the least impact on parcel shippers. The biggest impact in terms of retail consolidation centered on the issue of ease of returns for e-commerce companies.

When discussing this broader range of potential service changes, customers become slightly more concerned. They are typically only concerned if the change directly impacts their own service needs. But the aggregation of potential changes begins to impact their overall perception of the USPS and larger questions begin to emerge about the future of the Postal Service.

The Big Picture

In the context of the bigger picture, customers become very concerned about the future of the USPS. They are skeptical of the organization's ability to survive. They are worried about the future for letter mail because of the still-evolving internet and digital transmission for sending bills, payments, and related mail. Customers know digital mail is growing in use and will continue to erode First Class Mail volume and revenue. Customers realize this and see the impact on the larger capabilities of the USPS. Customers said “We need them to succeed…..we have no choice” and “Congress must act” to save them.

Due to the inability of the USPS to solve its financial woes, most believe that USPS will be “less viable” in the future.   “Death spiral” and “dead-end” were descriptors used by respondents. Customers desperately want USPS to survive, but they don't believe they will survive unless they are “saved”. In this context, customers are very worried and say will need to consider alternatives for their mail and shipping. They suggest strongly that more diversion from the USPS is likely because they must move to protect their own interests.

Given the scope of the SC research project, the impact of this much more worrisome customer sentiment could not be quantified. But the qualitative result is clear: Customers are very concerned and they will act if necessary as noted in the SC study, the USPS research reported by Gregory Whiteman, and in the ASCI survey of customer satisfaction.

However, the market research done by the USPS in August/September of 2011 and subsequently “abandoned”, as described in USPS-LR-N2012-1/LR70, would be much more consistent with the attitudes uncovered in our research. The potential runoff of volume away from the USPS could be considerably greater than the estimates made when the discussion was simply limited simply to “network rationalization”. The point here is that, when customers consider the breadth and depth of the formidable challenges facing the Postal Service rather than just the changes to first-class mail standards, they are much more concerned and much more likely to take much more drastic action shifting volume away.

Interestingly, despite the expected decreased usage of USPS parcel products, the parcels segment is considered by customers still to be potentially quite viable. On the parcel side, customers want the USPS to expand to compete in the market for parcels because USPS is seen as a low-cost service provider with an existing infrastructure that could provide good service. Customers want “speed and reliability” for their parcel shipments. But, respondents said, “they (USPS) need to speak our language, not force us to speak theirs.” Such competition might help generate more favorable pricing for all shippers. Customers see UPS and FedEx as the leading parcel delivery companies as noted in the ASCI study referenced above. Customers wish for the USPS to match the capabilities of the private carriers while maintaining lower rates. But many customers remain concerned due to the USPS’ “historical inability to execute programs in the market”.

Simultaneously, customers are hopeful for the USPS but also are wary of the service changes proposed by the Postal Service and they will divert volume if the changes negatively impact their business. Again, they have immediate choices available and they will shift, if necessary.

APPENDIX 2

DISCUSSION GUIDE – APWU PROJECT
DATE

PART I: Getting to Know Your Business and Parcels Management History

A. INTRODUCTION

I am ____________________ and I am with Shorter Cycles, a business consultancy. We are working for a client who is interested in the significant changes underway at the United States Postal Service (USPS or Postal Service). We will talk about those changes in greater detail in a few minutes.

But before we get started, I want to thank you and your company for your time and your interest in this very important issue. We are talking with you and other managers at companies that ship significant mail and parcel volume to both residential and commercial addresses.

Everything we discuss today will be treated as **CONFIDENTIAL.** In our written report to our client we will summarize our learning from all interviews. We will list a reference to all of the companies interviewed, but no attribution will be given as to the source of answers to any questions. Your name, and the names of all interviewees from all companies participating, will not be made public.

B. WHAT TO EXPECT TODAY

As noted in the Summary of Topics sent to you prior to this meeting, our discussion will last approximately one hour. Does that time frame still work for you? We will review your current mailing and shipping activity and discuss the impact of the proposed USPS network changes on your activity. We will discuss those proposed changes in more detail shortly.

The questions I ask will be both open-ended and with rating scales. During our time together I will use this Discussion Guide to help keep us both on track and on time. I know your time is very valuable and we respect that.

With your permission, I would like to record our conversation today so that I might reference it later when I prepare my report. I want to be sure to fully and accurately reflect your responses. I will be the only person listening to the recording and I will erase it completely following preparation of my report. Is it okay with you?

C. BUSINESS DEMOGRAPHICS

Company name: ____

Address: ____

____

Annual Revenue: $_______________

Total Employees: _______________

D. SHIPPING PROFILE

Prior to our meeting today, you were sent a "Summary of Topics to be Discussed" which included information about your company and your shipping habits. May I have a copy of that form? Let's review that for a moment to help focus our conversation.

NOTE: If respondent did not complete, pull out a blank form and fill it out. If the form is incomplete or inaccurate, ask for clarification. That's okay. I have a form here and we can fill it out now. ***Complete the form entirely. If respondent does not know an exact number, a "best estimate" is acceptable.***

NOTE: Review grid in detail.

Number of Company shipping locations: _________________

NOTE: Based on the discussion so far, is there anything you want to ask the respondent or is there other information to note here?

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E. IMPORTANCE OF SERVICE FEATURES

Let's begin by talking about what is important to you when it comes to shipping. Please rate the following service features in terms of importance when selecting a carrier and service for your **parcel** shipments.

0 = not at all important **10 = extremely important**

Service Features *NOTE: Record any key comments*

☐ **Speed or time-in-transit** (expected transit time) ________________________________

____

____

☐ **Cost** ____

____

____

☐ **Reliability** – meeting delivery date promised ____________________________________

____

____

☐ **Delivery Guarantee** – money back if delivery is late ______________________________

____

____

☐ **Tracking** – package-level detail available while parcel is in transit ____________________

____

____

☐ **Delivery confirmation** – proof of delivery _______________________________________

____

____

☐ **Proactive notification** of shipment, expected delivery date, delay, delivery ____________

____

____

☐ **Electronic availability of billing data** for your parcel shipments ____________________

____

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____

F. IMPRESSIONS OF THE USPS

☐ Now I would like to get your overall impressions of the USPS.

1. How would you describe the attributes of the USPS brand?

   ____
   ____
   ____
   ____
   ____

2. How would you describe your experience as a USPS customer?

   ____
   ____
   ____
   ____
   ____

Part II: Impact of the Proposed USPS Operational Changes

G. NETWORK RATIONALIZATION

Now I would like to discuss with you each of the potential changes proposed by USPS and how these changes might affect your business.

The first initiative is known "Mail Processing Network Rationalization Service Changes, 2012". We will refer to this as Network Rationalization. The USPS is proposing to close approximately half of its First Class Mail processing facilities. These are sorting facilities that are distinct from local delivery operations. As a result of Network Rationalization, First Class Mail would no longer be delivered in one day. The current standard of 1-3 days would change to 2-3 days. Periodicals standards would change from 1-9 days to 2-9 days.

☐ ☐

1. Were you aware of these proposed changes? YES NO

NOTE: If "YES" Proceed to Q2. If "NO", read the following statement and skip to Q3.

→ It is possible that this proposal could affect parcels as well. (***Skip to Q3)***

2. Are you aware that this proposal could affect service on parcels as well?

   YES ☐ NO ☐

3. In what ways would this proposed change impact your overall business?

☐ No impact ____
____
____

☐ Order-cash-cycle ____
____
____

☐ Customer service____
____
____

☐ Increased customer complaints ______________________________________
____
____

☐ Inventory costs ____
____
____

☐ Internal Processes (billing, payroll, etc.)____________________________
____
____

NOTE: Ask if there are more impact items and record below.

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____

4. Would the proposed network rationalization impact your use of USPS services in any way?

YES ☐ NO ☐

NOTE: If "NO", skip to Q10.

5. How would these changes affect your use of the following services?

NOTE: Circle a response for each class, note % change.

First Class Mail	**No Change**	**Increase**	**Decrease**	**% Chg** __________
Periodicals	**No Change**	**Increase**	**Decrease**	**% Chg** __________
Standard Parcels	**No Change**	**Increase**	**Decrease**	**% Chg** __________
Parcel Post	**No Change**	**Increase**	**Decrease**	**% Chg** __________
Parcel Select	**No Change**	**Increase**	**Decrease**	**% Chg** __________
Priority Mail	**No Change**	**Increase**	**Decrease**	**% Chg** __________

6. How likely is it that the proposed USPS network changes would cause your company to shift some or all of your parcel volume from the USPS to other carriers?

(0=not at all likely, 10=extremely likely) ☐

NOTE: If the answer is "4" or less, skip to Q9.

7. Approximately what percentage of your current USPS PARCEL volume might you shift to another carrier?

% Change ______________

8. In what other ways might the proposed network changes affect your mailing and shipping patterns? (shift mail to on-line, more drop shipping, etc.)

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____

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____

____

____

9. Do you believe there would be a change in your total PARCEL shipping **COSTS** as a result of the proposed network changes?

YES ☐ NO ☐

10. How would the changes in First Class Mail and the resulting elimination of 1-day delivery affect your perception of other USPS services?

Positively ☐ Negatively ☐ No Change ☐

Please elaborate ____

____

____

____

11. Specifically, would it impact your perception of Priority Mail?

Positively ☐ Negatively ☐ No Change ☐

Please elaborate ____

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12. Would a 50% reduction in processing facilities and the resulting downgrades in First Class Mail service standards impact the overall <u>value</u> you receive from the USPS?

YES ☐ NO ☐

13. What would be the impact if you were required to tender shipments by 12:00 noon in order to maintain current service levels?

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____
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____
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H. 6 DAY SERVICE to 5 DAY SERVICE

Another change being considered by the USPS is the elimination of Saturday service. This would be a **reduction** in the number of days of delivery and pick-up for First Class Mail and other mail products (including parcels) from **6 days per week** (Monday through Saturday) to **5 days per week** (Monday through Friday).

1. Were you aware of the proposed reduction from 6 to 5 days of service prior to this interview?

   YES ☐ NO ☐

2. In what ways would elimination of Saturday service impact your overall business?

   ☐ No impact ____
   ____
   ____

   ☐ Order-cash-cycle ____
   ____
   ____

   ☐ Returns become more cumbersome ______________________________
   ____
   ____

   ☐ Customer service____
   ____
   ____

   ☐ Increased customer complaints ________________________________
   ____
   ____

   ☐ Reduced on-line/catalog sales.________________________________
   ____
   ____

   ☐ Inventory costs ____
   ____

____

☐ Internal Processes (billing, payroll, etc.)________________________________
____
____

NOTE: Ask if there are more impact items and record below.

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____
____
____
____

3. Earlier we discussed how the proposed network rationalization and resulting changes to First Class Mail service standards would impact your mailing and shipping patterns. If Saturday delivery were eliminated in addition to the changes we discussed earlier, would the impact on your mailing and shipping activity be any different than what you described before?

   YES ☐ NO ☐

NOTE: If "NO", skip to Q7.

4. How would network rationalization and elimination of Saturday service together affect your use of the following services?

NOTE: May need to refer to prior response to Q5, Pg.5. Circle a response for each class, note % change.

First Class Mail	No Change	Increase	Decrease	**% Chg** ________
Periodicals	No Change	Increase	Decrease	**% Chg** ________
Standard Parcels	No Change	Increase	Decrease	**% Chg** ________
Parcel Post	No Change	Increase	Decrease	**% Chg** ________
Parcel Select	No Change	Increase	Decrease	**% Chg** ________
Priority Mail	No Change	Increase	Decrease	**% Chg** ________

5. How likely is it that network rationalization <u>and</u> elimination of Saturday service <u>together</u> would cause your company to shift some or all of your parcel volume from the USPS to <u>other carriers</u>?

(0=not at all likely, 10=extremely likely) ☐

NOTE: If the answer is "4" or less, skip to Q7.

6. Approximately what percentage of your current USPS PARCEL volume might you shift to other carriers?

% Change ____________

7. What is the likelihood that the <u>total</u> number of parcels your company ships with <u>ALL</u> carriers would change if Saturday delivery is eliminated?

(0=not at all likely, 10=extremely likely) ☐

NOTE: If the answer is "4" or less skip to Q8.

Please elaborate ____
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____
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8. In what other ways might the elimination of Saturday delivery affect your mailing and shipping patterns? (shift mail to on-line, more drop shipping, etc.)

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____

9. Do you believe there would be a change in your total PARCEL shipping **COSTS** if Saturday delivery were eliminated?

YES ☐ NO ☐

Please elaborate____
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____

____

10. How would the elimination of Saturday delivery impact your perception of Priority Mail?

    Positively ☐ Negatively ☐ No Change ☐

    Please elaborate ____
    ____
    ____
    ____
    ____

11. Would elimination of Saturday delivery impact the overall value you receive from the USPS?

    YES ☐ NO ☐

I. RETAIL / LOCAL POST OFFICE CONSOLIDATIONS

The USPS is considering the closure of approximately 10% of its Destination Delivery Units, local Post Offices, and other retail access locations.

1. Were you aware of the proposed reductions in the number of local facilities and retail locations prior to this interview?

   YES ☐ NO ☐

2. In what ways would reductions in the number of local facilities and retail locations impact your overall business?

   ☐ No impact ____
   ____
   ____

   ☐ Customer service____
   ____
   ____

   ☐ Returns become more cumbersome ______________________________

____

____

☐ Reduced on-line/catalog sales____

____

____

NOTE: Ask if there are more impact items and record below.

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3. Earlier we discussed how changes to First Class Mail service standards and the elimination of Saturday delivery would impact your shipping patterns. If, in addition to those changes, local facilities and retail access points were reduced by 10% would the impact on your shipping activity be any different than what you described before?

YES ☐ NO ☐

Note: Probe for impacts on drop shipping and product returns process.

Please elaborate ____

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____

4. Would there be a change in your Company's cost for shipping **PARCELS** as a result of a reduction in local facilities and retail locations service?

YES ☐ NO ☐

Please explain ____

____

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J. General Questions

1. In the event that any or all of these proposed changes occur, does your Company have a contingency plan in place?

   YES ☐ NO ☐

   Please describe ____
   ____
   ____
   ____
   ____

2. Which of the three proposed changes we have discussed today is of greatest concern to you?

   ☐ Reduced service standards for First Class Mail, including elimination of 1-Day delivery

   ☐ Elimination of Saturday service

   ☐ Reduction of the numbers of local facilities and retail access points (Post Offices, etc.)

3. At the beginning of our discussion, you described the USPS brand. How would the potential changes to the USPS that we have explored today impact your perception of the USPS brand?

   Positive ☐ Negative ☐ No Change ☐

   ____
   ____
   ____
   ____
   ____

4. What could the USPS do to win more of your business with their current service offering?

____
____
____
____
____

5. Do you believe the various USPS proposals we have discussed today would make the USPS more or less viable in the future? How and why?

More ☐ Less ☐ No Change ☐

Please explain ____
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____
____

6. What new or improved services might the USPS offer to become more competitive and win more of your shipping business?

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____

7. Is there anything else the USPS can do to win more of your parcel business?

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____

8. Please describe USPS <u>as you believe it will be</u> 5 years from now (financial condition, services, role).
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____
____
____
____
____

9. Please describe USPS <u>as you would like it to be</u> 5 years from now (financial condition, services, role).
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That concludes our session today and I want to sincerely thank you for your time, your feedback, and your interest in this very important matter.

NOTE: Ask the respondent to acknowledge receipt of the $100 check by signing below.

Date: ____________________, 2012 Respondent Signature: ________________________

Name (please print): ________________________

Appendix 3

Introduction

A Priority processing and transportation model was developed to estimate the potential impact of proposed Priority facility consolidations on service performance. This model estimated the potential change in service performance of Priority parcels and flats due to changes in travel distances resulting from the proposed Network Rationalization.

Model Results

The tables below present the expected change in service performance based on the number of Priority parcels and flats reaching their destination 3-digit ZIP code in 1, 2, 3, or 4 days, and the percent missing their Modern Service Standard (FY12 Qtr3 published standard). Table 1 provides model-estimated service performance statistics assuming an 8AM arrival deadline to the centroid of the destination 3-digit ZIP code. Table 2 provides the same statistics under a more stringent deadline of 7:30AM. Tables 3 and 4 present the same metrics for Priority flats instead of parcels.

Model Results - Priority Parcels

	Time-in-Network By Volume…				
	1-Day	2-Days	3-Days	4-Days	% Missing Published Service Standard
FY10 Baseline (112 Plants)	14.8%	65.9%	19.1%	0.2%	19.7%
Post-NR (129 Plants)	14.0%	65.4%	20.4%	0.3%	20.9%

Table 1. Priority Parcels Service Performance assuming 8AM destination arrival deadline

	Time-in-Network By Volume…				
	1-Day	2-Days	3-Days	4-Days	% Missing Published Service Standard
FY10 Baseline (112 Plants)	13.2%	61.5%	24.9%	0.3%	25.9%
Post-NR (129 Plants)	12.2%	60.0%	27.5%	0.4%	28.5%

Table 2. Priority Parcels Service Performance assuming 7:30AM destination arrival deadline

Model Results – Priority Flats

	Time-in-Network By Volume…				
	1-Day	2-Days	3-Days	4-Days	% Missing Published Service Standard
FY10 Baseline (112 Plants)	28%	57.3%	14.5%	0.2%	17.6%
Post-NR (129 Plants)	26.7%	57.7%	15.4%	0.2%	18.9%

Table 3. Priority Flats Service Performance assuming 8AM destination arrival deadline

	Time-in-Network By Volume…				
	1-Day	2-Days	3-Days	4-Days	% Missing Published Service Standard
FY10 Baseline (112 Plants)	25.3%	55.5%	19.0%	0.3%	23.5%
Post-NR (129 Plants)	23.5%	55.3%	21.0%	0.2%	26.2%

Table 4. Priority Flats Service Performance assuming 7:30AM destination arrival deadline

Model Inputs and Assumptions

Input Priority Volumes

The model simulated the flows of FY2010 ZIP3-to-ZIP3 average daily volumes of Priority Flats and Parcels derived from the FY10 ODIS dataset (NP11). The volumes were modeled as entering the network either at the centroid of the originating 3-digit ZIP code (representing retail entry), or at the outgoing facility for that ZIP code (representing dropship-entry). The entry point was determined by the volume's indicia code in ODIS. Volumes with a "stamped" or "metered" indicia code were assumed to enter at the ZIP code level, and volumes with a code of "other" were assumed to enter at the outgoing facility.

Volumes entering at the 3-digit ZIP code level were inducted at two times – 4pm and 6pm, with 30% of the volume being inducted at 4pm and the remaining 70% inducted at 6pm. Facility-entered volumes were inducted at the outgoing facility at a uniform rate between 8AM and 4PM.

No other product types were included in the model, so potential competition for processing and transportation resources with non-Priority products was not a factor.

Facilities and ZIP Code Assignments

A "Baseline" set of Priority facilities was created by starting with the facilities listed in Library Reference 15 (LR15) and then reducing the list to only those continental U.S. facilities identified in NP2 as processing Priority workloads. In the small number of cases where a Priority facility in NP2 did not exist in LR15, our best judgment was used in selecting the closest alternative. The final Baseline list contained 112 facilities. 3-digit ZIP codes were assigned to Priority facilities according to the ZIP-code assignments listed in NP2.

Scenarios

1) A "Baseline" FY2010 scenario was tested to establish a reference point against which the alternative

scenario(s) could be compared. The Baseline scenario used the Baseline facilities and ZIP code assignments described above.

2) A "Post-NR" network scenario was also developed to test to potential changes in service performance that could result from changes to the Priority facilities and ZIP code assignments under the proposed Network Rationalization. The set of 129 Post-NR Priority processing facilities was derived from the spreadsheet attached to Rosenberg’s POIR 5 Q4 response, filed Mar. 8, 2012, with minor modifications. The original list contained 133 Priority mail processing facilities in the continental United States. This included 3 International Sorting Centers (ISCs), which were not included in the model. Also, the Louisville, KY P&DC and Louisville Airport Annex Mail Processing Annex were combined into a single Louisville, KY facility for modeling purposes, resulting in a total of 129 distinct facilities.

The assignments of 3-digit ZIP codes to Outgoing and Incoming Facilities were also obtained from the same POIR 5 Q4 attachment spreadsheet. For roughly 1% of the 3-digit ZIP codes, their facility assignments had not been specified (i.e., they were marked “TBD”). In such cases, the baseline FY2010 assignments were used by default.

The same input volumes were used with both scenarios; so they only differed in their facilities and ZIP code assignments.

Transportation

The logic for determining the transportation mode (surface or air) between originating and destinating facilities was based on the First Class Mail transport modes specified in LR64. If LR64 indicated the interfacility FCM transport mode between two facilities was "Air" or “Surface” then the Priority volumes were also modeled as being transported via the same mode. If LR64 didn't specify the transportation mode between a pair of facilities, a 1000mi threshold was used to select between surface and air.

Surface transport was modeled as point-to-point between outgoing and incoming Priority facilities. Outgoing surface transport departed each facility at 12:30AM with a travel time determined by the straight-line mileage to the incoming facility, multiplied by a circuity factor of 1.28, and divided by a 46.5mph surface transport speed. The transported mail arrived at the incoming Priority facility after the calculated transport time had elapsed.

A surface transport delay was also incurred by all volumes entered at a 3-digit ZIP code to represent the transportation to the outgoing facility. Transportation began at the centroid of the 3-digit ZIP code and ended at the outgoing facility. The transport time was computing using the same assumptions described above regarding road circuity, travel speed, etc. Incoming volumes were dispatched from the incoming facility at 6:30AM and also incurred a similarly-computed transportation delay between the incoming facility and the centroid of the destination 3-digit ZIP.

Air transport was assumed to be handled by commercial carriers. After being dispatched from the outgoing facility at 12:30AM, all air-transported interfacility volumes were assumed to arrive at the destination facility at 8PM.

Operating Schedule and Critical Times

The following Priority processing windows were assumed, based on the testimony of Frank Neri (T-4).

Priority Outgoing: 3:00pm - 10:30PM
Priority Incoming: 5:00pm - 4:00AM

Facilities were assumed to have unlimited processing capacity, so facility equipment sets and machine throughputs were not a constraint. Outgoing priority volumes that failed to arrive by the end of the outgoing processing window (10:30PM) were held over until the following day. Similarly, incoming volumes that failed to arrive by the end of the incoming processing window (4AM) were also held over until the following day. As previously stated, outgoing volumes were dispatched from the outgoing facility at 12:30AM, and incoming volumes were dispatched from the incoming facility at 6:30AM.

Volumes were considered "delivered" upon reaching the centroid of their destination 3-digit ZIP code. An 8AM destination arrival deadline was used to determine whether volumes arrived "on-time" on Day *N*, or if they were considered "late" and were thus counted as arriving on Day *N*+1. A more stringent 7:30AM arrival deadline was also tested for comparison.

Service Performance Output

For each scenario, a service performance output file was generated containing, for every pair of Origin-Destination ZIP codes, the daily volumes of Priority parcels and flats delivered in 1, 2, 3, and 4-days. These raw results were then manually post-processed to compute the summary metrics presented in the Model Results section above.

1

APPENDIX 3-I

The table below lists the 112 Baseline Priority Facilities and 129 Post-NR Priority Facilities used in the model.

Baseline (112 Total)	Post-NR (129 Total)
ALBANY NY	ALBANY NY
ALBUQUERQUE NM	ALBUQUERQUE NM
AMARILLO TX	AMARILLO TX
ANAHEIM CA	ANAHEIM CA
	ATLANTA GA NDC
ATLANTA LDC GA	ATLANTA LDC GA
AUSTIN TX	AUSTIN TX
BALTIMORE MD	BALTIMORE MD
BATON ROUGE LA	BATON ROUGE LA
BILLINGS MT	BILLINGS MT
BIRMINGHAM AL	BIRMINGHAM AL
BISMARCK ND	BISMARCK ND
BOISE ID	BOISE ID
BOSTON MA	BOSTON MA
BUSSE METRO HUB IL	BUSSE METRO HUB IL
CENTRAL MASS MA	
	CASPER WY
	CEDAR RAPIDS IA
CHAMPAIGN IL	CHAMPAIGN IL
	CHARLESTON SC
CHARLESTON WV	CHARLESTON WV
CHARLOTTE LDC NC	CHARLOTTE LDC NC
CHATTANOOGA TN	
	CHEYENNE WY
	CHICAGO IL NDC
CINCINNATI OH NDC	CINCINNATI OH NDC
CLARKSBURG WV	
CLEVELAND OH	CLEVELAND OH
	COLUMBIA MO
COLUMBIA SC	COLUMBIA SC
COLUMBUS OH	COLUMBUS OH
DALLAS TX	
DENVER ANNEX CO	DENVER ANNEX CO
	DENVER CO NDC
	DES MOINES IA
DES MOINES IA NDC	DES MOINES IA NDC
DETROIT PMPC MI	
	DETROIT MI NDC
	DULLES VA
EAST TEXAS TX	
EL PASO TX	EL PASO TX
	EVANSVILLE IN
FARGO ND	FARGO ND
	FAYETTEVILLE AR
FAYETTEVILLE NC	FAYETTEVILLE NC
	FRESNO CA
FT WORTH TX	FT WORTH TX
	GRAND FORKS ND
	GRAND JUNCTION CO
GRAND RAPIDS MI	GRAND RAPIDS MI
	GREAT FALLS MT

Baseline (continued)	Post-NR (continued)
GREENSBORO NC	GREENSBORO NC
GREENVILLE SC	GREENVILLE SC
HARRISBURG PA	HARRISBURG PA
HOUSTON TX	
INDIANAPOLIS ANNEX IN	INDIANAPOLIS ANNEX IN
	INDIANAPOLIS IN
INDUSTRY CA	
IRON MOUNTAIN MI	
IRVING PARK IL	
JACKSON MS	JACKSON MS
	JACKSONVILLE FL NDC
JACKSONVILLE LDC FL	
KANSAS CITY KS NDC	KANSAS CITY KS NDC
	KANSAS CITY MO
KNOXVILLE TN	KNOXVILLE TN
	LAFAYETTE LA
LAS VEGAS NV	LAS VEGAS NV
LEXINGTON KY	
	LINTHICUM MD
LITTLE ROCK AR	LITTLE ROCK AR
LONG BEACH CA	
LOS ANGELES CA	LOS ANGELES CA
	LOS ANGELES CA NDC
LOUISVILLE KY	LOUISVILLE KY
LUBBOCK TX	LUBBOCK TX
MACON GA	MACON GA
MADISON WI	
	MCALLEN TX
	MEDFORD OR
MEMPHIS TN	MEMPHIS TN
	MEMPHIS TN NDC
	MERRIFIELD VA
	MIDLAND TX
MILWAUKEE PRIORITY WI	MILWAUKEE PRIORITY WI
MINNEAPOLIS MN	
MINNEAPOLIS/ST PAUL MN NDC	MINNEAPOLIS/ST PAUL MN NDC
	MISSOULA MT
ML SELLERS CA	ML SELLERS CA
MOBILE AL	MOBILE AL
MONTGOMERY AL	MONTGOMERY AL
NASHUA LDC NH	NASHUA LDC NH
NASHVILLE ANNEX TN	NASHVILLE ANNEX TN
NEW ORLEANS LA	
NJ LDC NJ	
NORFOLK VA	NORFOLK VA
NORTH HOUSTON TX	NORTH HOUSTON TX
	NORTH PLATTE NE
NORTH TEXAS TX	NORTH TEXAS TX
	NORTHERN NJ METRO NJ
NY LDC NY	NY LDC NY
OAKLAND CA	OAKLAND CA

Baseline (continued)	Post-NR (continued)
OKLAHOMA CITY OK	OKLAHOMA CITY OK
OMAHA NE	OMAHA NE
ORLANDO LDC FL	ORLANDO LDC FL
	OSHKOSH WI
PENSACOLA FL	PENSACOLA FL
PHILADELPHIA NDC	PHILADELPHIA NDC
PHOENIX PMPPC AZ	PHOENIX PMPPC AZ
PITTSBURGH LDC PA	PITTSBURGH LDC PA
PORTLAND OR	PORTLAND OR
PROVIDENCE RI	PROVIDENCE RI
	QUAD CITIES IL
RALEIGH NC	RALEIGH NC
	RAPID CITY SD
RENO NV	RENO NV
RICHMOND VA	RICHMOND VA
ROANOKE VA	ROANOKE VA
ROCHESTER LDC NY	ROCHESTER LDC NY
SAINT LOUIS MO NDC	SAINT LOUIS MO NDC
SALT LAKE CITY ASF UT	SALT LAKE CITY ASF UT
SAN ANTONIO TX	SAN ANTONIO TX
SAN BERNARDINO CA	SAN BERNARDINO CA
SAN FRANCISCO CA	SAN FRANCISCO CA
	SAN FRANCISCO CA NDC
SAN JOSE CA	SAN JOSE CA
	SANTA BARBARA CA
SANTA CLARITA CA	SANTA CLARITA CA
SEATTLE ANNEX WA	SEATTLE ANNEX WA
	SEATTLE WA NDC
SHREVEPORT LA	SHREVEPORT LA
SIOUX FALLS SD	SIOUX FALLS SD
SOUTH FLORIDA LDC FL	SOUTH FLORIDA LDC FL
SOUTH JERSEY NJ	SOUTH JERSEY NJ
SOUTHERN CONN CT	
SOUTHERN MAINE ME	
	SOUTHERN MARYLAND MD
SPOKANE WA	SPOKANE WA
SPRINGFIELD NDC	SPRINGFIELD NDC
STERLING LDC VA	
SUBURBAN MD	
	ST LOUIS MO
TAMPA LDC FL	TAMPA LDC FL
TOLEDO OH	
TRAVERSE CITY MI	TRAVERSE CITY MI
TUCSON AZ	
TULSA OK	
WASHINGTON DC	WASHINGTON DC
WASHINGTON DC NDC	WASHINGTON DC NDC
	WATERLOO IA
	WEST PALM BEACH FL
WEST SACRAMENTO CA	WEST SACRAMENTO CA
WICHITA KS	WICHITA KS

Appendix 4

Strategic Choice: "Last-Mile" or Full Network

The USPS appears to have strategically embraced a focus on the "last-mile" capabilities of delivery and has encouraged the market to take advantage of the delivery economies of stopping at every address in the country (nearly) every day. While it is true that the Postal Service enjoys a certain cost advantage in delivery, there are many more elements to success than just delivery. Consequently, "last-mile" capability is very important, but it is also not sufficient to ensure the future success of the USPS. The Postal Service must develop a fully-capable network based parcel market strategy. The success of the entire organization may rest upon such a commitment to grow in a new direction.

The Postal Service has a long history of disinvesting in the network. Work-share pricing incentives have long motivated mailers to pre-sort mail and drop-ship deep into the USPS network In parcels, the Parcel Select product induces shippers to drop ship into the system at the DDU, completely avoiding the internal network operations and creating a dependency on other transport suppliers to provide the network and sorting capabilities. But the Parcel Select product is not a long-term solution for growth; it leaves too much revenue on the table for others, and it separates the USPS from the original customer who ships the parcels.

The apparent focus on the "last-mile" certainly begs the question: Is this the stated strategy of the Postal Service? And what are the consequences of such a strategy relative to other alternatives? Further, has the case been made to strategically shift from a network-capable organization to a primarily delivery-focused organization? And, will that case be presented to the PRC, to Congress and to the public?

The USPS has a strategic choice to more fully embrace the parcel market or to contract into a delivery-only, last-mile vendor to other transportation suppliers. This is not a strategic decision that should be made by default nor through incremental decisions to cut costs here and there. The opportunity to strategically shift toward the parcel business will greatly help the USPS maintain universal service for mail while providing an extremely competitive service in the growing and very attractive parcel market.

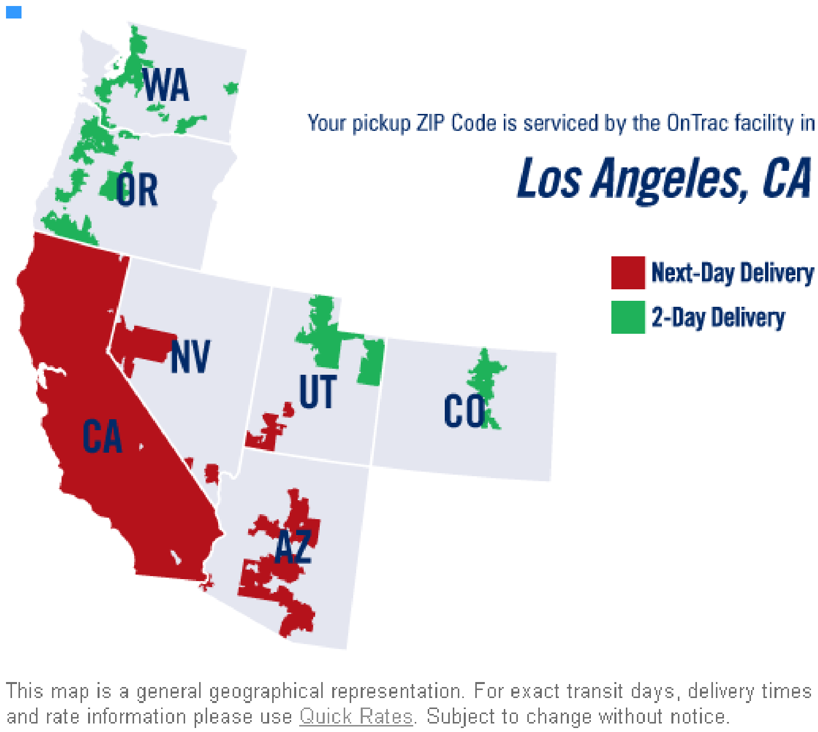
Last-mile, delivery-only focus has many negative aspects:

- Detachment from direct shipping customers
- Partial participation in available revenue streams
- Vendor status with major private network providers
- Risk of losing delivery advantage as markets shift
- Strategically weak position

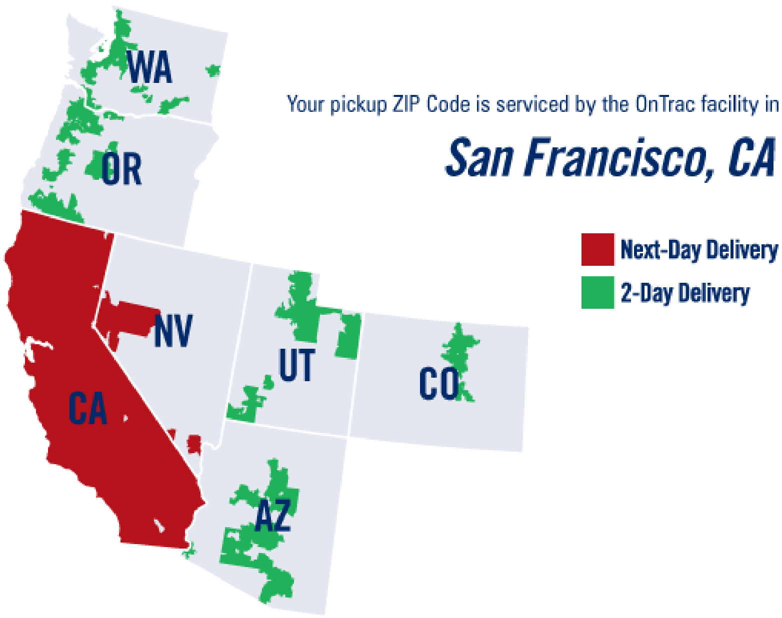
Full network capability in parcels provides many advantages:

- Participation in the total revenue streams of customers
- Direct customer relationships
- Full product portfolio to capture optimum revenue
- Strategic power to compete against major private carriers
- Fully utilize the inherent strength of the USPS delivery capability
- Strategically stronger position

Appendix 5
OnTrac Service Maps[21]



[21] OnTrac corporate website, http://www.ontrac.com/ziptools/default.aspx (Aprill 22, 2012)



This map is a general geographical representation. For exact transit days, delivery times and rate information please use Quick Rates. Subject to change without notice.

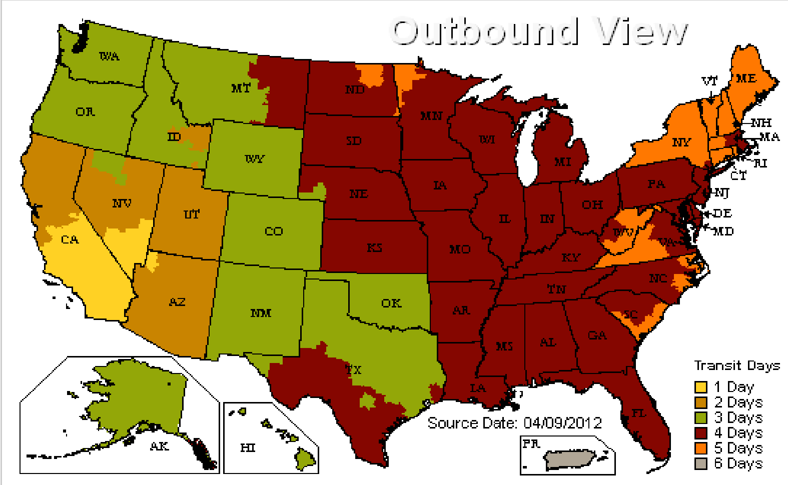
APPENDIX 5 cont'd

UPS Service Maps[22]

[22] UPS corporate website, http://www.ups.com/maps/results (April 22, 2012)

U.S. Ground Map Results

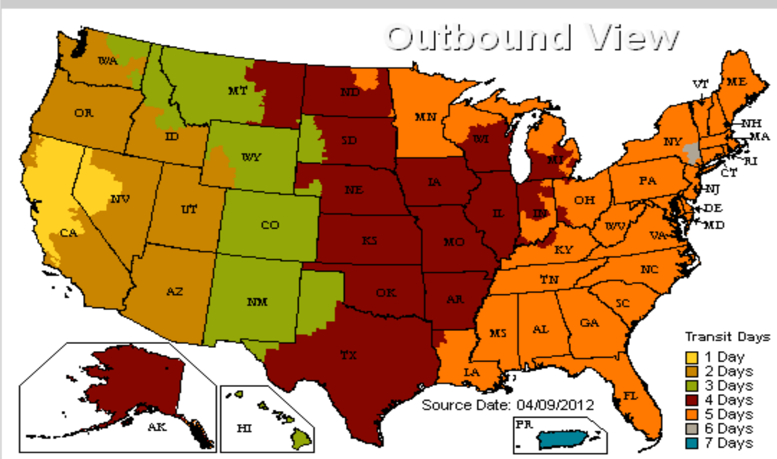
Business days in transit from: BEVERLY HILLS, CA 90210



Service Map colors may vary due to differences in hardware and software. This map is a general representation of UPS Ground transit times. For service availability and to calculate the delivery time for a package shipped between a specific origin and destination worldwide, select **Calculate Time & Cost** in the **Shipping** tab.

U.S. Ground Map Results

Business days in transit from: SAN FRANCISCO, CA 94101



Service Map colors may vary due to differences in hardware and software. This map is a general representation of UPS Ground transit times. For service availability and to calculate the delivery time for a package shipped between a specific origin and destination worldwide, select **Calculate Time & Cost** in the **Shipping** tab.